Bulkowski’s Trading Quiz

Here’s the latest quiz. What chart patterns can you find? A hint appears below and answers on the next page.

**Hint.** Look for the following chart patterns (If you find others, great!): channel, busted head-and-shoulders, 3 falling peaks, broadening bottom, wedge.
Price has broken out of the channel upward, on high volume.

**Question 1:** Do you buy, short, or avoid trading this stock?

**Question 2:** If trading this one, what is the target price?

**Question 3:** If trading this one, what is the stop price?

The answers appear below and a chart on the next page.

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**Answer 1:** Buy. Why? Because I know what’s coming.

**Answer 2:** You can measure the channel height and project it upward from the top of the channel. The height, measured vertically, is $1.71. Added to the breakout price of 17.60 gives a target of 19.31. The price closed at 19.75, so that’s no real help.

**Answer 3:** Place a stop below the channel low, at A, 16.15. The close is at 19.75, a cool 18% drop. That’s much too far. 2x volatility is $1.20, so a volatility stop at 16.80 is closer but still 15% away. The 3 red lines show a Fibonacci retrace of the move from A to the recent high. Placing a stop below the lowest of the 3 red lines (a 62% retrace), means a stop at 17.60. That still 11% but it’s close enough with volatility being what it is.
I became interested in the stock a few bars before the last one shown on the above chart. Why? The answer is on the next page.
This is a high and tight flag. That’s when price doubles (at least 90%) in 2 months or less. The launch point is at the base of the flagpole, at 16.15, and price peaked at 31.90, the day before the last bar. That’s a climb of 98% in just over a month. I show the chart (and all charts) on the logarithmic scale. Notice how the price climb tends to flatten the channel and the price rise since August. What was a hilly, rounded landscape in the first chart (page 1) is now a more sedate rise.

Here’s my notebook entry for the trade when I bought on the last bar shown.

Date placed: 2/13/06  
Order type: market open tomorrow  
Date Bought: 2/14/06  
Bought at: 31.03  
Stop, % loss: 27.81 or 10% down  
Volatility, stop: 27.10, 13.1%.  
Upside target: 30.21 high on 2/10 - 16.15 trend low on 12/28/05 = 14.06 height x 50% = 7.03. 30.21+7.03 = 37.24.  
Future market direction: Down?  
Indicators: RSI: oversold. CCI: buy signal today, MACD: very high momentum. Bollinger: midway between middle and upper band  
Associated commodities: None  
Score and price target: +2, 39.18 using generic score  
Industry and stock rank: 18/46 and 1/10  
SAR: None above except round number at 35. Congestion from 30 to 28.  
Buy reason: HTF with upward breakout  
Buy again plans: None. No bullets left.
The top chart is the RSI which says the stock is overbought and ripe to fall. CCI comes next and it shows a buy signal followed by a sell signal on the last 2 bars of the price chart (I only saw the buy on 2/13), from the CCI and DCCI lines crossing. Next comes MACD which is bullish, high momentum on the histogram chart. Bollinger bands show price riding up in the middle of the top two bands. Notice how the bands changed from a narrow width to a much wider one as price took off.
Dissecting my notebook entry, I placed a stop at 27.81, 10.3% below the buy price of 31.03. The volatility stop was too far away at 13.1% from the current close. I used the measure rule for HTFs, half the height of the flagpole to project a price target. That was 37.24. I scored the chart pattern using my scoring system for chart patterns. For more information, consult my book Trading Classic Chart Patterns for the logic, but you won’t find this pattern in the book. That’s why it says I used a generic score – the same scoring method as for classic patterns but I used average numbers to extrapolate the result for patterns I haven’t applied the scoring method to. Clear as mud, right? It’s not important. Scores above 0 have a better probability of hitting their price targets than those with scores below 0.

Industry and stock rank. The industry, building materials, ranked 18 out of 46 for performance over the last 6 months. Inside the industry, this stock ranks first out of ten stocks for performance over the same 6 months. All that means is I like to see a strong industry movement and strong stock performance. Will the results prevent me from taking a trade? No.

Here’s the chart.

More on the next page
As each day ticked higher, I looked at the stock and ran a volatility check. When the volatility stop moved up, I raised my stop. You can read the comments yourself. At one point, 2x volatility was over $3. That placed the stop much too far away, so I chose to narrow the spread. Why use a volatility stop? Because it offered the only way to set a stop except for guessing. Usually, I like to hide beneath a minor low but with a straight line run, there's no minor low!

Nevertheless, the stop was often 10% or more below the current close. That's a huge give back but one that's necessary in order to stay in the trade.

“2/15/06 Stop raised to 28.68, current vol stop setting.
2/19/06 Stop raised to 29.07, an odd number (7 cents) above the volatility stop of 29. The market has been up but the stock really hasn't followed. With intraday price range narrowing, I'm thinking the stock will tumble, taking me out for a loss. Why not tighten the stop more? Because I want to give it every opportunity to climb, but my guess is it won't.
2/22/06 Stop raised to 30.33. Vol stop is 30.25 and I want to avoid round number, rounded up. Vol stop is also 10.7% down, which is large.
2/23/06 Stop raised to 31.07, breakeven and vol stop is 30.98.
2/24/06 Stop raised to the vol stop of 32.22.
2/27/06 Stop raised to 32.68, the vol stop setting.
2/28/06 Stop raised to 33.68, 20 cents above the vol stop setting of 33.48.
3/1/06 Stop raised to 35.07, above the vol stop of 34.76 because it's almost 12% down.
3/2/06 Stop raised to 36.03
3/3/06 Stop raised to 37.03. This is well above the vol stop of 35.17, -15%. Today is an outside day with a $3.50+ high-low range. I think the end is near but still want to give price a chance to run. Thus, since price closed up a buck, I'm raising my stop a buck.
3/6/06 Stop raised to 38.21. This is well above the 37.76 vol stop setting but the wide ranging day 2 days ago caused CCI to issue a sell. With today's small range, it suggests a topping out of the stock. So, I tightened the stop.
3/7/06 The stock closed lower and I figure everyone else will sell at tomorrow’s open. In the past, the stock has tumbled on the open then recovered throughout the day. Except for today. It closed lower. With CCI signaling a sell 3 days ago, I think it's time to cut the giveback to 0 and exit.

Date placed: 3/7/06
Date sold: 3/8/06
Sold: market open order
Sold at: 39.89
Sell reason: I think this is finally topped out and everyone is going to head for the exits and quickly!"

They did exit at once. The open at 39.89 was well below the prior close of 41.12. Price on the day I sold dropped to a low of 38.53, so I think I did well.

The target was 37.24 but the scoring system had a target of 39.18 (based on the median rise of HTFs). I beat both targets. Since the trade, the stock has hit overhead resistance except for today. When I checked last, price was moving up again.

The end